U.S. Department of the Interior
Office of Inspector General

ADVISORY REPORT

STATUS OF INTERFUND LOANS AND OTHER OBLIGATIONS, GOVERNMENT OF THE VIRGIN ISLANDS

REPORT NO. 98-I-187
DECEMBER 1997

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

DEC 22 1997

MEMORANDUM

TO: The Secretary

FROM: Wilma A. Lewis
Inspector General

SUBJECT SUMMARY: Final Advisory Report for Your Information - "Status of Interfund Loans and Other Obligations, Government of the Virgin Islands" (98-I-l87)

Attached for your information is a copy of the subject final advisory report. The overall objective of our audit, as amended, is to determine: (1) all amounts borrowed by the General Fund from special fund accounts during fiscal years 1995, 1996, and 1997 and (2) the outstanding balances of such inter-fund loans and the unobligated balances of Federal grant accounts. The purpose of this advisory report is to provide the Government of the Virgin Islands officials with preliminary information on the status of interfund loans and other outstanding obligations to allow them to make informed decisions on the Government's finances.

We found that, as of September 30, 1997, the Government had outstanding obligations (excluding bonded debt) totaling $570 million as follows: $120 million for unauthorized and unrecorded interfund loans; $21 million for authorized and recorded interfund loans; $150 million for disaster-related loans received from Federal Emergency Management Agency after Hurricanes Hugo and Marilyn; $14 1 million for retroactive salary increases and fringe benefits for fiscal years 1992 through 1997; $76 million for income tax refunds for tax years 1994 through 1996; at least $49 million for services provided by approximately 4,000 vendors, as represented by invoices and purchase orders processed by the Department of Finance during March through September 1997; and $13 million for the Government Employees Retirement System for the Early Retirement Incentive, Training and Promotion Act of 1994 and regular retirement contributions for September 1997. These obligations total $208 million more than the projected General Fund operating revenues of $362 million for fiscal year 1998. The Government faces a potential operating deficit of about $97 million for fiscal year 1998, and the payment of any portion of the $570 million debt would increase this deficit accordingly.

Because this was an advisory report issued for the purpose of providing Govemment officials with preliminary information based on our ongoing audit, we did not make any recommendations. We will provide more detailed information and specific recommendations in another report to be issued at the conclusion of the audit.

If you have any questions concerning this report, please contact me at (202) 208-5745 or Mr. Robert J. Williams, Assistant Inspector General for Audits, at (202) 208-4252.

Attachment

V-IN-VIS-005-97-A

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

DEC 1 9 1997

ADVISORY REPORT

Honorable Roy L. Schneider
Governor of the Virgin Islands
No. 21 Kongens Gade
Charlotte Amalie, Virgin Islands 00802

Honorable Lorraine L. Berry
President
Legislature of the Virgin Islands
Post Office Box 477
Charlotte Amalie, Virgin Islands 00804

Subject: Advisory Report on the Status of Interfund Loans and Other Obligations, Government of the Virgin Islands (No. 98-I-187)

Dear Governor Schneider and Senator Berry:

This report provides, for your information, preliminary findings disclosed by our audit of inter-fund loans and Federal grant balances of the Government of the Virgin Islands. We will provide more detailed information and specific recommendations in another report to be issued at the conclusion of the audit.

We found that, as of September 30, 1997, the Government had at least $570 million in outstanding obligations (excluding bonded debt), or about $208 million more than the projected General Fund operating revenues of $362 million for fiscal year 1998. This amount consisted of the following: $120 million in loans from the Special and Other Funds bank account that were not authorized by law or recorded in the Government's financial records; an additional $21 million in interfund loans that were authorized by law and recorded in the financial records; and $429 million in other operating obligations, such as amounts owed to taxpayers, vendors, Government employees, the Government Employees Retirement System, and the Federal Emergency Management Agency (FEMA). The unauthorized inter-fund loans of $120 million were made to cover Federal Insurance Compensation Act (FICA) and health insurance costs for Governmental employees for pay periods during April 1995 through July 1997. These loans were publicly disclosed by the Commissioner of Finance during his confirmation hearings before the Legislature of the Virgin Islands on October 2, 1997, because "it was important to inform the Senators because of an audit that the Inspector General's Office is preparing to release." The existence of these interfund loans was not included in financial information that the Department of Finance provided to the Legislature, at its request, in August 1997.

BACKGROUND

In March 1995, the Legislature, anticipating that the Government of the Virgin Islands may not be able to meet payroll costs in March and August 1995 (which had three Government paydays), passed Act No. 6068, which the Governor signed into law. The Act authorized the Governor, through the Commissioner of Finance, "to borrow, on a temporary, short-term basis, an amount not to exceed $15 million for the exclusive purpose of meeting the recurring payroll cost of the Government of the Virgin Islands when the Governor determines that the revenues collected are insufficient to cover any payroll which comes due during such insufficiency." The Act further stated, "No short-term loan may be made which cannot be retired with revenues collected for the fiscal year in which it was obtained." The Act had an expiration date of September 30, 1995. However, in November 1996, the Legislature passed Act No. 6128, which the Governor signed into law, that (among other provisions) retroactively extended the period to repay any funds borrowed under the authority of Act No. 6068 to September 30, 1997.

Based on the authority provided by Act No. 6068, the Government, during the period of March to September 1995, borrowed a total of $20 million from special fund accounts to meet its payroll obligations. Of the $20 million borrowed, only $8.5 million had been repaid ($5 million in June 1995 and $3.5 million in July 1997) as of September 30, 1997. Thus, $11.5 million remained outstanding.

Despite the borrowing authority provided by Act No. 6068, the Government has not been able to meet its operating expenses with current operating revenues. This situation was made worse by a general economic downturn and by the impact of Hurricanes Marilyn in September 1995 and Bertha in July 1996. The fiscal year 1998 Executive Budget included estimated General Fund revenues totaling $361.9 million and General Fund expenditures totaling $459.5 million, or a revenue shortfall of $97.6 million.[1] Also, the payment of any portion of the outstanding obligations discussed in this report would increase that shortfall accordingly.

The Government has three main checking accounts: the General Fund bank account (at the Chase Manhattan Bank), which is used for the general revenues and operating expenses of the Government; the Special and Other Funds bank account (at the Banco Popular de Puerto Rico), which is used for revenues and expenses related to special programs, such as Federal grant programs and a variety of specially funded local programs; and the Payroll Fund bank account (at the Chase Manhattan Bank), which is a "zero balance" clearing account. Each

[1]To balance the budget, the fiscal year 1998 Executive Budget also included, as General Fund revenue sources, $18.1 million in contributions from other funds, $33 million from privatization of the Virgin Islands Water and Power Authority, $27 million from a FEMA Community Disaster Loan, $4.5 million from a FEMA State Share Loan, and $15 million from "economic stimulus investments." However, as of September 30, 1997, with the exception of the inter-fund contributions, these supplemental revenue sources did not appear to be firm commitments because the privatization of the Water and Power Authority had not been approved by the Legislature, FEMA had not released the additional loan funds, and private investments in new casino resorts and other similar projects had not materialized. Additionally, the fiscal year 1998 General Fund appropriation acts passed by the Legislature totaled $460.9 million rather than the $459.5 million estimated in the Executive Budget.

pay period, sufficient monies from the General Fund and the special funds are deposited into the Payroll Fund bank account and used to pay employee salaries and other related payroll expenses, such as withholding and FICA taxes, retirement contributions, and health insurance premiums.

In accordance with generally accepted government accounting principles, the General Fund and each of the Government's special funds should have complete sets of general ledger accounts, which consist of balance sheet accounts (assets, liabilities, and equities) and operating accounts (revenues and expenditures). These general ledger accounts are maintained in the computerized Financial Management System maintained by the Department of Finance and are used as the basis for preparing annual financial statements of the Government. Generally accepted government accounting principles require the issuance of a comprehensive annual financial report, and the Single Audit Act of 1984 requires that audited financial statements be issued, as part of an overall audit of all Federal financial assistance, within 12 months of the end of each fiscal year. However, the most recent audited financial statements issued by the Government were for the fiscal year ended September 30, 1994.

OBJECTIVE AND SCOPE

The overall objective of our audit, as amended, is to determine: (1) all amounts borrowed by the General Fund from special fund accounts during fiscal years 1995, 1996, and 1997 and (2) the outstanding balances of such interfund loans and the unobligated balances of Federal grant accounts. The purpose of this advisory report is to provide Government officials with preliminary information on the status of inter-fund loans and other outstanding obligations to allow them to make informed decisions on the Government's finances. This segment of our review was conducted during September and October 1997 and included reviews of records and interviews with personnel at the Department of Finance, the Bureau of Internal Revenue, and the Government Employees Retirement System, all of which are on St. Thomas, Virgin Islands.

Our review was made, as applicable, in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary under the circumstances. Because of the limited scope of this part of the review, we assessed the internal controls only to the extent necessary to evaluate the status of the Government's outstanding obligations. Upon completion of the overall audit, we will issue another report that will include more detailed information on the interfund loans and Federal grant balances of the Government of the Virgin Islands and make specific recommendations to address any deficiencies identified by the audit.

PRIOR AUDIT COVERAGE

During the past 5 years, the Office of Inspector General has not issued any reports that specifically addressed interfund loans, Federal grant balances, or the Government's deficit. However, in November 1985, we issued the special report "Government of the Virgin Islands

1985 Operating Deficit" (No. V-TG-VIS-30-85). That report stated that: (1) the fiscal year 1985 deficit was in excess of $50 million and that proposed deficit reduction initiatives of $46.9 million were undertaken too late in the fiscal year to have any impact on the deficit; (2) the Government was meeting cash-flow requirements by deferring payments of payroll-related employee/employer contributions and by borrowing from other special purpose funds within the Division of Treasury (about $4.2 million outstanding as of May 1985); and (3) the true financial condition of the Government was unknown and the existing financial crisis was exacerbated by financial information that was not current or accurate. The report recommended that the Governor: (I) prepare a detailed deficit reduction plan identifying specific areas of expenditure reduction and sources of revenues to resolve the deficit; (2) request assistance from the then-Assistant Secretary for the Office of Territorial and International Affairs to establish a Federal/local task force to address financial management system problems; and (3) require that local managers who administer Federal grant programs review the status of all current grants to ensure that those funds were used for their intended purposes.

Our current review has shown that the same type of problems continue to exist in that: (1) unless additional revenue sources are found or expenditures are held to levels below those appropriated by the Legislature, the General Fund could end fiscal year 1998 with an operating deficit of as much as $97 million; (2) the level of interfund borrowing to meet cash-flow requirements has increased by more than 33 times (from $4.2 million to $14 1 million) since the issuance of the November 1985 report; and (3) the financial condition of the Government is still unknown because, as of September 30, 1997, audited financial statements had not been issued for fiscal years 1995 and 1996.

In April 1994, the Office of Inspector General issued the special report "Bonded Debt of the Government of the Virgin Islands and its Autonomous Agencies" (No. 94-I-5 13). The report stated that, as of March 3 1, 1993, the Government and its autonomous agencies had outstanding bonds totaling $445.6 million. The report also stated that from 1994 through maturity, the remaining debt service requirement on those bonds, including $423.3 million of interest, would total $868.9 million, or about $8,600 in bonded debt for every resident of the Virgin Islands. The report further stated that, as of August 1993, the Government and its autonomous agencies had issued an additional $13.9 million in bonds and had been authorized or were planning to issue $232.3 million more in bonds. The report concluded that, in general, pledged revenues should be sufficient to meet the debt service requirements of the then-outstanding bonds but that the issuance of the additional $232.3 million in bonds could adversely affect the ability of the Government's Internal Revenue Matching Fund, the Water and Power Authority's water system, and the Port Authority's aviation division to meet further debt service requirements. The report did not contain any recommendations. However, since the issuance of the report, the Government has been authorized by the U.S. Congress to restructure its bonded debt, allowing the issuance of additional bonds. Additionally, as of September 30, 1997, the Virgin Islands Water and Power Authority was seeking an increase in its bond ceiling from $130 million to $220 million.

PRELIMINARY RESULTS OF REVIEW

We found that although the Legislature, in March 1995, authorized the Governor to borrow funds not to exceed $15 million to meet payroll costs, the Government borrowed and recorded $20 million based on that authorization and borrowed an additional $120 million during the period of April 1995 to July 1997 that was not authorized by the Legislature or recorded in the Government's financial records. As of September 30, 1997, the Govemment had outstanding obligations (excluding bonded debt) totaling $570 million as follows: $120 million for unauthorized and unrecorded interfund loans; $21 million for authorized and recorded inter-fund loans; $150 million for disaster-related loans received from FEMA after Hurricanes Hugo and Marilyn; $14 1 million for retroactive salary increases and fringe benefits for fiscal years 1992 through 1997; $76 million for income tax refunds for tax years 1994 through 1996; at least $49 million for services provided by approximately 4,000 vendors, as represented by invoices and purchase orders processed by the Department of Finance during March through September 1997; and $13 million for the Government Employees Retirement System for the Early Retirement Incentive, Training and Promotion Act of 1994 and regular retirement contributions for September 1997. Title 33, Sections 3101 and 3108, of the Virgin Islands Code contains prohibitions against deficit spending. However, these outstanding obligations existed because the Government did not have sufficient General Fund revenues to meet all operating expenses and made it a priority to meet its biweekly payroll. In addition, the Department of Finance did not implement sound financial management practices to ensure that interfund loans and other obligations were recorded in the official financial records, and it did not inform the Legislature of the unrecorded interfund loans until our audit was initiated. As a result, as of September 30, 1997, the Government had a total operating debt of about $570 million, or $208 million more than the projected General Fund operating revenues of $362 million for fiscal year 1998. The Government faces a potential operating deficit of about $97 million for fiscal year 1998, and the payment of any portion of the $570 million debt would increase this deficit accordingly. In addition, because the Department of Finance borrowed $120 million from the Special and Other Funds bank account to cover biweekly payroll costs but did not record those loans in the financial records of the Government, the balances of individual special fund accounts maintained in the Department of Finance's Financial Management System were not accurate. Moreover, there was little assurance that Federal funds were not used to pay for General Fund payroll-related expenditures because Federal and local funds were commingled in the Special and Other Funds bank account.

Interfund Loans

As of September 30, 1997, the Government had outstanding interfund loans totaling about $141 million, which consisted of $120 million in unauthorized and unrecorded loans and $21 million in additional interfund loans that were legally authorized and recorded in the financial records.

Unauthorized Interfund Loans. We found that because the Government was unable to meet its biweekly payroll and payroll-related expenses, the Department of Finance established the practice of borrowing, but not recording in its financial records, amounts from the Special and Other Funds bank account to cover the payroll-related expenses for FICA taxes and health insurance premiums. Department of Finance officials told us that this practice had been occurring for the past 3 fiscal vears but that, because of a decline in General Fund revenues, the Department of Finance was unable to reimburse the Special and Other Funds bank account during this period. However, based on our November 1985 report "Government of the Virgin Islands 1985 Operating Deficit" (No. V-TG-VIS-30-85), we found that this practice was used as far back as fiscal year 1985 (see Prior Audit Coverage). As of September 30, 1997, the Payroll Fund owed the Special and Other Funds bank account a total of $120 million. There was no legislative authorization to borrow this money, and these "unauthorized loans" have not been recorded against individual special fund accounts. Accordingly, the balances maintained by the Department of Finance's Financial Management System for the General Fund and special fund accounts were not accurate. Specifically, the financial records for the General Fund should include a "Due to Other Funds" liability account for the $120 million in loans, and the financial records for each special fund should include a "Due From Other Funds" asset account for its appropriate share of the $120 million in loans.

According to the Department of Finance's Accounting Manual, the Payroll Fund was established so that "payroll costs chargeable to various funds may be segregated and consolidated." Furthermore, Department of Finance officials told us that the Payroll Fund operated as a zero balance fund, or "wash account." Therefore, according to Department of Finance officials, amounts should have been transferred to the Payroll Fund bank account from the General Fund bank account on a biweekly basis to cover the payroll and payroll-related expenses. However, because of an insufficient balance in the General Fund bank account, the Government used the Special and Other Funds bank account to pay for the payroll-related expenses. In order for the Payroll Fund to operate as a zero balance fund, the Department of Finance prepared checks from the Payroll Fund bank account to reimburse the Special and Other Funds bank account for amounts borrowed. These checks were held by the Department of Finance's cashier awaiting authorization from Division of Treasury officials to deposit the checks into the Special and Other Funds bank account when there were sufficient General Fund revenues to cover the checks. Accordingly, as of September 30, 1997, the Department of Finance's cashier held, at the Department's offices on St. Thomas, 87 checks, totaling $120 million, that were written against the Payroll Fund bank account for expenses related to pay periods from April 24, 1995, through July 3 1, 1997. The checks were made payable to either the FICA Taxes Withheld Fund ($91 million) or the Health Insurance Fund ($29 million). (Both funds are part of the Special and Other Funds bank account.) Based on our review of the financial information contained in the Department of Finance's Financial Management System for the FICA Taxes Withheld Fund and the Health Insurance Fund for fiscal years 1995 through 1997, we found that the two funds had a combined deficit of about $130 million for fiscal years 1995 through 1997. (The $10 million difference could be accounted for by other interfund transactions and transactions in transit that should be reconciled during the year-end process when the financial statements for these fiscal years are prepared.)

According to Title 3, Chapter 11, of the Virgin Islands Code, the Department of Finance is responsible, among other duties, for exercising "general supervision over, and custody of, the special and public trust funds." Furthermore, according to the Department of Finance's Accounting Manual, the "Special Fund" group consists of about 400 funds "created to account for certain types of revenues specifically earmarked for certain activities of the Government, and also for grants and/or contributions to finance certain special programs sponsored by the Insular Government or jointly with the Federal Government." In addition to most Federally funded programs, many locally funded programs are accounted for through the Special and Other Funds bank account, including the Internal Revenue Matching Fund (pledged for debt service on most Government bonds), the Health Revolving Fund (used to finance hospital operations), the Tourism Advertising Revolving Fund (used to promote the tourism industry), the Transportation Trust Fund (used to finance highway construction and repairs), and the Paternity and Child Support Revolving Fund (used to receive and distribute child support payments). Therefore, the Special and Other Funds bank account contained both local and Federal funds. According to the Accounting Manual, "the use of the revenues and receipts credited to these [special] funds are restricted to the purposes determined by the provisions of the legislation or directives creating them, and expenditures and obligations against these funds shall be made only in accordance with such provisions."

We reviewed the activity in the Special and Other Funds bank account and found that the account was overdrawn on 141 days during fiscal years 1996 and 1997, including by $12 million on December 4, 1995. We also found that the bank started to charge the Government for overdrafts in November 1996 and that, through September 30, 1997, such charges totaled about $12,150. Because the Special and Other Funds bank account commingled both local and Federal funds and the bank account was overdrawn on many occasions, including amounts of up to $12 million, we believe that Federal funds may have been borrowed to pay for non-Federal payroll-related expenses. Additionally, we believe that the unauthorized loans also restricted the amount of funds available for the payment of legitimate expenses of the Federal and local programs funded through special funds because of the frequently overdrawn condition of the Special and Other Funds bank account.

In an October 28, 1997, press release, the Commissioner of Finance stated, "Borrowing from various government funds to meet operating expenses predates the current administration and the borrowing by the [current] administration is authorized by law." Through the press release, the Commissioner further stated that the Legislature approved interfund borrowing through a 1995 law (Act No. 6068) which "authorized the Governor to borrow up to $15 million on a temporary, short-term basis to meet payroll"; another 1995 law (Act No. 6084) which "gave the Director of Management and Budget authority to adjust appropriations in order to pay fixed, mandatory costs", and a 1996 law (Act No. 6086) which allowed the Governor "to use funds as may be necessary and available in the Treasury of the Virgin Islands as an immediate match to Federal Disaster Assistance funds." The release further stated: "The point is that we have borrowed from the funds only when it has been absolutely necessary. The borrowing has clearly been within the bounds of the law and we intend to pay it back just as soon as our revenue picture improves."

We concur with the Commissioner's statement that "borrowing from various government funds to meet operating expenses predates the current administration." Our November 1985 report on the Government's 1985 operating deficit concluded that such interfund borrowing occurred as far back as fiscal year 1985 (see Prior Audit Coverage). However, we disagree with the Commissioner's conclusion that the $120 million in unrecorded loans from the Special and Other Funds bank account was "within the bounds of the law" as follows:

Act No. 6068 limited borrowing to a maximum of $15 million, which the Government exceeded by making loans totaling $20 million. Additionally, although a subsequent amendment to the Act extended the loan repayment date to September 30, 1997, $11.5 million was still outstanding as of that date.

- Act No. 6084 authorized the Director of Management and Budget to "adjust any item of appropriation in the budget of the Government of the Virgin Islands for the fiscal year ending September 30, 1995" and limited such "adjustments" to a maximum of $7 million. In our opinion, this law did not authorize the interfund borrowing of monies that were not appropriated, but the transfer of monies among appropriations. Even if Act No. 6084 authorized interfund borrowing, such authorization should have been limited to $7 million and only during fiscal year 1995. As of September 30, 1997, the outstanding balance of unrecorded interfund loans made during fiscal year 1995 totaled $18.2 million (out of the $120 million total amount of such loans). We were not able to determine whether additional unrecorded interfund loans were made during fiscal year 1995 but were repaid prior to September 30, 1997.

- Act No. 6086 (among other provisions) authorized the Governor to use "such sums as may be necessary and available in the Treasury of the Virgin Islands as an immediate match to federal disaster assistance funds." Federal disaster assistance funds totaling more than $109 million were provided for the purpose of emergency recovery and repair work after Hurricane Marilyn in September 1995. The Act authorized the use of "available" funds to pay the local matching share of expenses under the Federal disaster assistance program but did not authorize the use of "available" funds to meet Government payroll expenses (averaging about $13 million per pay period).

In our opinion, the unrecorded loans of $120 million from the Special and Other Funds bank account that were made during the period of April 1995 through July 1997 were not authorized by the Legislature and were therefore improper. In addition, the unauthorized loans may be in violation of Title 33, Section 3 10 1, of the Virgin Islands Code, which states:

> No officer or employee of the Virgin Islands shall make or authorize an expenditure from, or create or authorize an obligation under, any appropriation or fund in excess of the amount available therein; nor shall any such officer or employee involve the government in any contract or obligation for the payment of money for any purpose, <u>in advance of appropriations made for such purpose</u>, unless such contract or obligation is authorized by law. [Emphasis added.]

Further, the Government's failure to record these loans in its financial records as liabilities of the General Fund and receivables of the special funds was contrary to generally accepted government accounting principles. Specifically, Section 1100.10 1 of the Codification of the Government Accounting and Financial Reporting Standards states:

> A govemment accounting system must make it possible both: (a) to present fairly and with full disclosure the financial position and results of financial operations of the funds and account groups of the governmental unit in conformity with generally accepted accounting principles and (b) to determine and demonstrate compliance with finance-related legal and contractual provisions.

Authorized Interfund Loans. We also found that certain special funds were owed about $21 million for authorized interfund loans, which consisted of $11.5 million still outstanding on the loans of $20 million made in accordance with Act No. 6068 (see Background section) and an additional $9.6 million borrowed by the Government in 1996. Regarding the $9.6 million in loans, the Government, in March 1996, borrowed $3.1 million from the AMPAC Settlement bank account, which was established with funds from the settlement of a case against an insurance company that defaulted on policyholder claims after Hurricane Hugo in 1989. The $3.1 million was used as an allotment to the University of the Virgin Islands for operating expenses. Additionally, in August 1996, the Government borrowed $6.5 million from the St. John Capital Improvement Fund for General Fund expenses. These two loans were still outstanding as of September 30, 1997. All of these loans were recorded in the financial records of the related funds.

Other Outstanding Obligations

In addition to the interfund loans totaling $141 million, we found that, as of September 30, 1997, the Government had other outstanding obligations totaling $429 million as follows:

- FEMA was owed about $150 million for Community Disaster Loans provided to the Government. Specifically, in May 1996, FEMA denied the Government's request to convert the $44.3 million outstanding balance (including interest) of the 1989 Hurricane Hugo loan to a grant. In addition, the Government had not requested that FEMA convert the $96.5 million outstanding balance (including interest) of the 1995 Hurricane Marilyn loan to a grant. The Government also owed FEMA $9.5 million (including interest) on a State-share Loan that was provided to allow the Government to meet the state matching requirement for FEMA disaster assistance funds.

- Governmental employees were owed $141 million[2] for the estimated cost of salary increases and related fringe benefits based on union negotiations (concluded and pending) for fiscal years 1992 through 1997.

- Taxpayers were owed $76 million[3] for income tax refunds for tax years 1994 through 1996, which consisted of $23 million for tax years 1994 and prior years, $26 million for tax year 1995, and $27 million for tax year 1996.

- Vendors were owed at least $49 million,[4] which consisted of $43 million for miscellaneous disbursement vouchers and purchase orders (for about 4,000 vendors) processed but not paid by the Department of Finance during March to September 1997, $4 million for about 1,000 vendor payments for which checks had been prepared but insufficient funds precluded the checks from being issued to the vendors, and $2 million for about 1,000 vouchers that had been rejected by the accounts payable system because of data entry errors or insufficient data (these vouchers were still pending completion of processing). Of the $43 million for miscellaneous disbursement vouchers and purchase orders that were processed but not paid, $12 million represented amounts owed by the General Fund to 16 of the Government's special funds.

- The Government Employees Retirement System was owed $13 million, which consisted of $7 million for unfunded portions of the Early Retirement Incentive, Training and Promotion Act of 1994 and $6 million for Government contributions and loan payments to the Retirement System for the two pay periods in September 1997.

Conclusion

With general operating obligations of $570 million, or $208 million more than the projected General Fund operating revenues of $362 million for fiscal year 1998, the financial condition

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[2]Legislative hearings were held on December 2, 1997, to identify funding sources for a union contract for 3,200 Governmental employees, which the Governor had signed and submitted to the Legislature for approval. During the hearings, Governmental financial managers testified that the contract includes salary increases totaling $13 million but that, in exchange for these increases, the union agreed to forego $45 million in retroactive salary increases due for fiscal years 1993 through 1996. We will verify this information as part of the ongoing audit for inclusion in another report.

[3]During the December 2, 1997, legislative hearings, Governmental financial managers testified that the amount of income tax refunds owed to taxpayers had increased to $99 million. We will verify this information as part of the ongoing audit for inclusion in another report.

[4]The total amount owed to vendors is most likely greater than the $49 million reported here because this amount includes only vendor invoices that had been processed by the Department of Finance. The number of vendor invoices held by individual agencies pending transmittal to Finance for processing is not known. For example, the Virgin Islands Water and Power Authority said that it was owed $22 million for electric and water service provided to Governmental agencies. However, our review disclosed that only $5.3 million in Authority invoices had been processed by the Department of Finance. During the December 2, 1997, legislative hearings, Governmental financial managers testified that the amount owed to vendors had increased to $67 million. We will verify this information as part of the ongoing audit for inclusion in another report.

of the Government of the Virgin Islands is weak. Unless additional revenue sources are identified, the Government faces a potential operating deficit of about $97 million for fiscal year 1998, and the payment of any portion of the $570 million in obligations discussed in this report would increase that deficit accordingly. As evidenced by the similarity between the findings contained in this report and those contained in our November 1985 report on the Government's 1985 operating deficit (see Prior Audit Coverage), the Government's financial condition has grown steadily worse over the past 12 years. Although that decline was made worse by the economic downturn and extraordinary expenses that resulted from Hurricanes Hugo in 1989, Marilyn in 1995, and Bertha in 1996, the financial condition could have been strengthened through more diligent efforts by the Government to address financial management deficiencies.

We believe that if the Government had taken meaningful, long-term corrective actions in response to the hundreds of recommendations made in about 150 audit reports we have issued since October 1982 (when the Office of Inspector General assumed responsibility for Federal audit oversight in the Virgin Islands), the Government would have been in a better financial position as of September 30, 1997. Specifically, our audit reports have repeatedly included recommendations for the Government to improve its ability to maximize revenue collections, reduce operating expenses (particularly in the area of procurement), improve overall financial management, and increase the efficiency and effectiveness of program operations. Although the Government, in its responses to our audit recommendations, has generally addressed the specific problems or questioned costs discussed in the audit reports, it often has not addressed recommended long-term changes in its operating procedures. The Virgin Islands Bureau of Audit and Control has likewise made hundreds of recommendations in about 290 audit and memorandum reports issued since May 1982 (when that Bureau was established) that could have resulted in improved financial management practices within the Government.

We further believe that the Government will be able to correct its current financial crisis only by making significant changes in its overall financial management practices. Specifically, it should aggressively collect amounts it is owed, comply with competitive procurement requirements, control the number of its employees and the related payroll costs, promote more efficient and effective program operations, and monitor and report on its financial condition through audited financial statements issued in a timely and accurate manner. Although this preliminary report does not contain any recommendations, we will make recommendations in our audit report on interfund loans and Federal grant balances issued at the conclusion of the audit.

Government of the Virgin Islands Response and Office of Inspector General Reply

The draft of this report was issued on November 21, 1997, and the Governor and the President of the Legislature were given the opportunity to provide written comments, by December 3, 1997, for inclusion in the final report. As of December 8, 1997, we had not received any written response to the draft report. However, during legislative hearings that were held on December 2, 1997, the Virgin Islands Director of Management and Budget and the Commissioner of Finance provided updated information on the amounts owed to taxpayers and vendors (see footnotes 2-4 in this report) and disagreed with our inclusion of amounts owed to FEMA and to special funds. Their specific comments and our replies are as follows:

FEMA Loans. The Governmental officials stated that the $150 million outstanding balance of disaster-related loans owed to FEMA should not be included in the amount of Government operating debt because the loans are long-term obligations. They stated that, at a maximum, only the amount owed during the current fiscal year should be included as an operating debt. We recognize that the FEMA loans are to be repaid over a period of up to 10 years. On page 5 and again on page 11 of this report, we stated that "the payment of any portion of the $570 million debt [which includes the $150 million owed to FEMA] would increase this [the fiscal year 1998] deficit accordingly." Additionally, the objectives of our ongoing audit and this interim advisory report are not to issue an opinion on the exact financial position of the Government as of a specific date. That is the purpose of obtaining full-scope financial statement audits, such as those required annually by the Single Audit Act of 1984. Rather, the purpose of this report is to inform senior-level Governmental officials of the total outstanding obligations of the Government to assist them in making informed decisions (short- and long-term) regarding those obligations and their impact on the Government's ability to meet its operating expenses. Therefore, we believe that inclusion of the total amount owed to FEMA is appropriate.

- Interfund Loans. The officials also stated that unauthorized, unrecorded interfund loans of $120 million should not be included in the amount of Government operating debt because the loans are amounts that the Government "owes to itself." The Commissioner of Finance, using an analogy, stated that the interfund loans are similar to an individual taking funds from a personal savings account and transferring the funds to a personal checking account. However, we disagree with this analogy because the Special and Other Funds bank account, from which funds were borrowed to meet General Fund payroll expenses, contains monies that belong to several hundred different "funds." Section 1100.102 of the Codification of the Government Accounting and Financial Reporting Standards defines a "fund" as an "accounting entity" in which financial resources "are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with regulations, restrictions, or limitations." In accordance with this definition, the Government's many special funds, whose monies are deposited into the Special and Other Funds bank account, include funds that were: (1) established by legislation and are restricted by such legislation for specific public purposes (for example, the Tourism Advertising Fund); (2) established by administrative directive based on specific legal or contractual requirements and are restricted by such legal or contractual requirements (such as funds used to account for Federal grants); and (3) established by administrative directive based on a trustee relationship held by the Government (such as the Unemployment Insurance Fund). In all three cases, the monies deposited into those funds would have some form of restriction that would preclude their use without approval from either the Legislature, the Federal Government, or another entity with which the Government had a contractual or trustee relationship. Because unauthorized interfund loans of $120 million were not allocated or recorded to specific special funds and the Special and Other Funds bank account was overdrawn on many occasions, legally or contractually restricted monies could have been included in the amounts borrowed to meet payroll expenses. Therefore, we believe that the loans represent valid obligations of the General Fund which must be considered by Governmental officials.

In our opinion, in addition to the requirements imposed by laws, regulations, contractual obligations, and generally accepted accounting principles, the Government has a trust responsibility to the residents of the Virgin Islands to accurately record and report on all of its financial activities. This responsibility includes recording in the financial records of the respective funds all known outstanding obligations, including the obligations discussed in this report.

Because this report does not contain any recommendations, a further response is not required. However, if you have any questions regarding the report, please contact Mr. Arnold E. van Beverhoudt, Jr., Director of Insular Area Audits, at (340) 774-8300.

The Inspector General Act, Public Law 95-452, Section 5(a)(3), as amended, requires semiannual reporting to the U.S. Congress on all audit reports issued, the monetary impact of audit findings, actions taken to implement audit recommendations, and identification of each significant recommendation on which corrective action has not been taken.

We appreciate the assistance of Government of the Virgin Islands personnel in the conduct of our audit.

Sincerely,

Wilma A. Lewis
Inspector General

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